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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 859

C. L. ASHTON ET AL.,

Petitioners,

vs.

CAMERON COUNTY WATER IMPROVEMENT DISTRICT No. ONE.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION.

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BRIEF OF RESPONDENT IN OPPOSITION.

Summary Statement of Matters Involved.

The primary question to be determined in this case is whether the Circuit Court of Appeals of the Fifth Circuit is correct in holding the Municipal Bankruptcy Act constitutional, said opinion being set out in full in the records of this case, beginning on page 144 and continuing to and including page 150. Opinion rendered on March 3, 1936, by

Presiding Judge Foster before Foster, Sibley and Duncan.

It is to be noted in said opinion that Judge Foster upheld the Municipal Bankruptcy Act and decided that the United States Supreme Court in the case of the *Continental Illinois National Bank & Trust Company* v. *Chicago, Rock Island and Pacific Railway Company*, 294 U. S. 648, had virtually decided said law constitutional.

It is to be observed that petitioners attack the opinion of Judge Foster upon six grounds which are set forth on pages two and three of said application.

It is the contention of the District that the opinion of the Circuit Court of Appeals is correct insofar as the law involved in this case and since the opinion states a correct conclusion of law, that the application for writ of certiorari should be denied.

Summary of Argument.

Point A.

The decision of the Circuit Court of Appeals is not contrary to the prior decisions of this Honorable Court but on the contrary said opinion is in direct harmony with the decision of the *Continental Illinois National Bank & Trust Company* v. *Chicago, Rock Island and Pacific Railway Company* case which opinion was written by Judge Sutherland.

Point B.

The Act of May 24, 1934, being the act in question, does not violate the 10th Amendment of the Federal Constitution which provides powers not delegated to the United States by the Constitution are reserved to the States.

Point C.

The Act of May 24, 1934, being the act in question, does not impair the rights of the State in any way.

Point D.

The Act of May 24, 1934, being the act in question, does not violate the 5th Amendment to the Federal Constitution in that it deprives the bondholders of their property without due process of law, for the reason that due process of law is given and said act does not apply unless 66⅔ per cent of the bondholders agree thereto and it is conceded then to be for their best interest.

Point E.

The Reconstruction Finance Corporation has ample authority to come to the aid of the Irrigation Districts and advance money to said districts to enable the districts to carry on and furnish water to the farmers to make crops where they could not otherwise do so.

ARGUMENT.

POINT A.

The decision of the Circuit Court of Appeals is not contrary to the prior decisions of this Honorable Court but on the contrary said opinion is in direct harmony with the decision of the Continental Illinois National Bank & Trust Company v. Chicago, Rock Island and Pacific Railway Company case which opinion was written by Judge Sutherland.

The Act of May 24, 1934 does not conflict with the decisions of this Honorable Court and in this connection we wish to submit the latest decision upon this question which is commonly known as the Railroad Reorganization Act which was held constitutional on April 5, 1935, by an able opinion of Judge Sutherland, and in order that the Court may un-

derstand the similarity and broadness of the decision, we will give a view of the points of the similarity which we are paralleling for the convenience of this Court.

For the convenience of the Court, we will call the act which is held constitutional as the Railroad Act and the act under question the Summers-Wilcox act.

The railroad act, the constutionality of which has been upheld, contains the following provisions.	The Summers-Wilcox Act, the constutionality of which is yet to be decided, contains the following.
	FIRST—Parties.
This act includes corporations, railroads and other transportation companies.	This act includes municipalities, political subdivisions, cities, villages, townships, unincorporated taxing districts, schools, drainage, irrigation, reclamation, levy, sewer or paving, sanitary, port improvements, or other districts.
	SECOND—Cost.
This act requires that the petition must be filed with the clerk accompanied by a check of $100.00, which shall be in addition to the usual fees required under the act of bankruptcy.	This act requires the payment to the clerk of a filing fee of $100.00 which shall be in addition to the usual fees required to be collected by the court.

THIRD—Judge's Duty.

This act requires upon the filing of the petition, the Judge shall enter an order either approving it as properly filed under this section and that it has been filed in good faith, or he must dismiss it.	This act requires that the Judge shall enter an order approving it if properly filed, and if satisfied that it complies with the act and has been filed in good faith, or if not so satisfied, he must dismiss it.

FOURTH—The Payment of Debts.

This act requires that if the person is bankrupt or unable to meet its debts as they mature, they shall be entitled to the provisions of the act.	This act requires that if a District is unable to meet its debts as they mature, it shall be entitled to the benefits of said Act.

FIFTH—Plan of Settlement.

This act requires that a plan of settlement shall have been proposed affecting any one class and it shall not affect any other debts which do not come within the class.	This act requires that it shall affect only those of a certain class and shall not affect any other debts of a different class.

SIXTH—Notices.

This act requires notice shall be by publication.	This act requires that notice shall be by publication.

SEVENTH—Confirmation by Bondholder.

This act requires that the plan of settlement must be confirmed by 66⅔% of the holders of the indebtedness of the class involved.

This act requires that the plan of settlement must be approved by 66⅔% of the class of indebtedness involved in so far as taxing districts are concerned and 75% when it affects cities and towns.

EIGHTH—Confirmation by the Court.

This act requires that the court upon final hearing must find that the plan of settlement is for the best interests of the holders of the indebtedness and has been made in good faith before he approves said settlement.

This act requires that the court shall find that the plan has been made in good faith and that it is for the best interests of the bondholders and that the District is able to carry out its plan of settlement before the settlement is finally approved.

NINTH—Time Limit.

This act provides an emergency time limit.

This act provides an emergency time limit.

TENTH—Equity.

This act provides that the judge must be satisfied as to the good faith and filing and of the equity of the plan.

This act provided that the judge must find that the plan is fair, equitable, and for the best interest of the creditors and does not discriminate unfairly in favor of any claim of creditors.

ELEVENTH—Binding Effect.

This act provides that if the plan is approved by the Court, it shall be binding upon all of the non-assenting creditors of the same class.	This act provides that if the plan has been approved by the Judge, it shall be binding upon all of the non-assenting creditors of the same class.

It will be understood from the parallel references that the two acts are absolutely parallel in so far as purpose and results are concerned, the only material difference is that the Railroad Act applies only to corporations, while the Sumners-Wilcox Act extends to municipalities and taxing agencies, but this difference will be discussed in a different point of this brief.

We believe that a casual glance of the similarities, that the constitutionality of the Act will at once become apparent. We wish however, to give a few quotations to some of the things mentioned by Judge Sutherland in the Railroad opinion. It is first to be noted that the allegation of the railroad in so far as its bankruptcy is concerned, uses the following language.

"Unable to meet its debts as they mature."

Judge Sutherland, in his opinion, says that the act "Permits any railroad corporation which is insolvent or unable to meet its debts as they mature, to effect a plan of reorganization."

He further says, "No plan may be fully approved by the commission until it has been accepted in writing on behalf of the creditors holding ⅔ in amount of the claims of each class affected by the plan, and on behalf of the stockholders, ⅔ of the stock of each class";

And Judge Sutherland, further states, "Upon confirmation of the plan, it is to be binding not only upon the corporation and all stockholders and creditors generally, but upon all secured creditors of each class, of which ⅔ in amount shall have accepted the plan."

Judge Sutherland states that the Court has been called upon to decide its constitutionality and whether or not it affects the due process clause, etc. Then the Judge follows with a long history of the bankruptcy act and holds the law constitutional and uses the following language:

> "The confirmation or legalization of a scheme of arrangement under such circumstances, is no more than is done in bankruptcy when a composition agreement with the bankrupt debtor, if assented to by the required majority of the creditors is made binding on the non-assenting minority."

The judge closes his opinion with the following findings:

> "It follows from what has now been said that in its general scope and aim is within the powers conferred by the bankruptcy clause of the constitution and we so hold."

This opinion decides the constitutionality of the act in question in favor of the appellee herein.

Discussion of the Frazier-Lemke Act

It might and perhaps will, flash in the mind of the reader of this brief of the decision of Judge Brandeis, decided May 27, 1935, in regard to the Farmers Bankruptcy Act, which Judge Brandeis held to be unconstitutional, because it is in violation of the "due process" clause of the constitution, and if that should be in violation of the constitution, why not the Summers-Wilcox Act? We believe that this is a fair question and one worthy of a careful consideration, which we will try to give at this time.

It is to be noted in the Frazier-Lemke Act that Mr. Radford was the owner of a farm secured by a mortgage of $8,000.00 and later another thousand and that the farm at the time the loan was made was valued at $18,000.00; that the $9,000.00 was to run 34 years at 6% interest. Radford alleges an emergency. He had the land appraised on December 1, 1934 and the appraised value was $4,445.00. It is to be noted that Mr. Radford failed to obtain the acceptance of the requisite majority of numbers and amount in regard to the composition of creditors. It is to be noted that under the laws of the State of Kentucky that the bank had at least five rights in respect to the foreclosure of his mortgage. It is also to be noted that the Frazier-Lemke Act caused all the giving to come from Radford and not the loan company, and there is absolutely no equity in this act. The court properly held that the act was in violation of the constitution, because of the "due process" clause, but in so holding, held that all laws in regard to composition of creditors were binding and of full force and effect and showed the difference why they are binding. We will quote in a few minutes from the opinion, but we wish to state at this time that composition of creditors is unlike the Frazier-Lemke Act in at least the following particulars:

(1). The Sumners-Wilcox Act benefits the bondholders and is for their benefit as well as the District's benefit;

(2). The Sumner's-Wilcox Act cannot be invoked until at least 66⅔% of the bondholders approved the same;

(3). The Sumners-Wilcox Act is nothing more nor less than an agreement between the District on one side and the great majority of the bondholders on the other side for their mutual benefit and there are other differences, but these are sufficient to properly understand Judge Brandeis' quotation, which is as follows:

"Nor do the provisions of the bankruptcy act concerning compositions afford any analogy to the provisions of paragraph 7. So far as concern the debtor, the composition is an agreement with the creditors in lieu of a distribution of the property in bankruptcy—an agreement which 'originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by his creditors.' *Nassau Smelting & Refining Works, Ltd.* v. *Brightwood Bronze Foundry Co.*, 265 U. S. 269, 271, 44 S. Ct. 506, 507, 68 L. Ed. 1013; *Myers* v. *International Trust Co.*, 273 U. S. 380, 383, 47 S. Ct. 372, 71 L. Ed. 692. So far as concerns dissenting creditors the composition is a method of adjusting among creditors rights in property in which all are interested. In ordering the adjustment, the bankruptcy court exercises a power similar to that long exercised by courts of law, *Head* v. *Amoskeag Mfg. Co.*, 113 U. S. 9, 21, 5 S. Ct. 441, 28 L. Ed. 889; and of admiralty, *The Orleans* v. *Phœbus*, 11 Pet. 175, 183, 9 L. Ed. 677. It is the same power which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite majority of the creditors. *Shaw* v. *Railroad Co.*, 100 U. S. 605, 25 L. Ed. 757; *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 46 S. Ct. 549, 70 L. Ed. 1028. Compare *National Surety Co.* v. *Coriell*, 289 U. S. 426, 53 S. Ct. 678, 77 L. Ed. 1300, 88 A. L. R. 1231; *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, 54 S. Ct. 298, 78 L. Ed. 465, 90 A. L. R. 391. In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court. Never, so far as appears, has any composition affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the mortgagee provided for in paragraph 3 of the Frazier-Lemke amendment

(11 U. S. C. A., Sec. 203 (s) (3). They are not analogous to the socalled adjustment compelled by paragraph 7 (11 U. S. C. A., Sec. 203 (s) (7))."

From the quotation above set out, it would be idle and useless for me to draw a distinction, because Judge Brandeis has so beautifully and so clearly differentiated between the two acts and this case, in our opinion, supports the constitutionality of the Sumners-Wilcox Act upon all of its different angles.

There are a great many other decisions which support the constitutionality of this Act that would be appropriate to cite at this time, but since the citing of the last word of the Supreme Court does, in our opinion, decide the question.

In the case of the Imperial Irrigation District, in the District Court of the United States for the Southern District of California, McCormick, District Judge, probably has the latest decision on the Sumners-Wilcox Act. He discusses the constitutionality of the Act from several different angles and part of his opinion would be material to this brief, and, therefore, we will give part of his opinion, as follows:

"The constitutionality of Section 80, as added to the National Bankruptcy Act on May 24, 1934, is challenged by the objectors. I think the statute is valid as far as any of its terms concern this proceeding.

"The grant of federal power in bankruptcy matters is found in Article I, Section 8, of the Constitution, which provides:

" 'The Congress shall have power (4) to establish * * * uniform laws on the subject of bankruptcies throughout the United States;'

and in the co-efficient investiture of national authority in Clause 18 of the same Section and Article of the organic law of the nation, which reads:

" 'The Congress shall have power (18) to make all laws which shall be necessary and proper for carrying into execution the foregoing powers.'

"The verbiage of these basic delegations of power to the national legislature by the people of the United States is broad and inclusive. Everything and everyone that Congress may have the will to place within 'bankruptcies' and which are not manifestly without the 'subject of bankruptcies' as developed by changing economic condition and interpreted by the Supreme Court is valid legislation under these applicable clauses of the Constitution. The only limitations are those prescribed in the Constitution itself. (*Gibbon* v. *Ogden,* 9 Wheaton I.) I find nothing therein that renders Section 80 void as this Act applied to the Imperial Irrigation District or to this proceeding by it.

"The Supreme Court, without dissent, in recent cases involving Section 77 of the Bankruptcy Act, relating to the reorganization of railroads, sustained the constitutionality of legislation that is not unlike the statute under consideration in this proceeding. (*Continental Illinois Bank & Trust Company* v. *Chicago, Rock Island & Pacific Railway Co.,* decided April 1, 1935.) Both sections are emergency measures enacted as aids to national economic recovery. Both are remedial statutes and accordingly must be broadly interpreted to accomplish their purposes.

"Justice Sutherland, in the learned and exhaustive opinion of the Court, in the *Rock Island Railway* cases reviewed the history of bankruptcies both in England and in the United States. He pointed out the difference between 'bankruptcy' in the two countries, and also traced the valid evolution and judicially sanctioned extension of 'the subject of bankruptcies' with the meaning of the Constitution, and in that connection said:

" 'The fundamental and radically progressive nature of these extensions becomes apparent upon their mere

statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they may be, have not gone beyond the limit of congressional power; but rather have constituted extension into a field whose boundaries may not yet be fully revealed.'

"There is good reason to believe that the municipal debt readjustment provisions of the Act of May 24, 1934, are well within the area of the field of constitutional enactments adverted to be the learned justice..

"The evidence submitted at the hearing on January 31 clearly showed that the District is unable to meet its debts as they mature, that default has existed as to its outstanding bond and registered warrant obligations since July 1, 1932, and that this unmeetable financial situation has been mounting year by year since that time. The dislocation of market conditions for farm products, the excess of credit allowances on farm lands and the depreciation of acreage values, coupled with the most disastrous water shortage in the Imperial Valley, demonstrate beyond any doubt that the District is 'bankrupt' within the meaning of the Constitution.

"Under the *Rock Island Railway* case, *supra*, a quasi-public corporate body that was 'unable to meet its debts as they mature' was held to be properly subject to Congressional legislation within the bankruptcy clauses of the Constitution. The District involved in this proceeding is also a public body, and because it is also a governmental unit of the State of California it is not without the Constitutional pale of Congressional

authority on the 'subject of bankruptcies throughout the United States,' as far as any of its functions that are sought to be affected by Section 80 in this proceeding is concerned.

"In the early case of *Cohens* v. *Virginia,* 6 Wheaton 414, the Supreme Court, in discussing power that is granted by the language of the Constitution in national matters, speaking through Chief Justice Marshall, said:

" 'That the United States form, for many, and for most important purposes, a single nation, has not yet been denied. In war, we are one people. In making peace, we are one people. In all commercial regulations, we are one and the same people. In many other respects, the American people are one; and the government which is alone capable of controlling and managing their interests in all these respects, is the Government of the Union. It is their government, and in that character they have no other. America has chosen to be, in many respects, and to many purposes, a nation; and for all these purposes, her government is complete; to all these objects, it is competent. The people have declared, that in the exercise of all powers given for these objects it is supreme. It can, then, in effecting these objects, legitimately control all individuals or governments within the American territory. The constitution and laws of a state, so far as they are repugnant to the constitution and laws of the United States, are absolutely void. These states are constituent parts of the United States. They are members of one great empire—for some purposes sovereign, for some purposes subordinate.'

"There is nothing in the municipal debt readjustment act that usurps unsurrendered state sovereignty. The dual aspects of national and local governmental authority are expressly safeguarded and conserved. The private or proprietary element of an irrigation district is sufficiently distinct and definite to bring it within the purview of the bankruptcy power of Con-

gress. This is especially true where the state, as the creator and dominant power of the district's governmental functions, has given its consent. Compare *Merriwether* v. *Garrett*, 102 U. S. 482."

And then again, after he refers to the equity of the plan, he says:

"This showing, coupled with the large majority approval of all those creditors who are affected by the plan, comes close to demonstrating that the plan 'is fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any class of creditors.'

"The small minority of objecting creditors asserts that notwithstanding this apparently favorable showing, as far as affected creditors are concerned, it should not be approved, because, as previously stated, it impairs their lien rights under the California Irrigation District Act as that law stood at the times of the First and Second issues of bonds by the District. They claim that the First issue is superior, paramount and prior to all other issues, and that the Second has the same status except as to the First, and that therefore the Court should so classify such bonds as the objectors own, and relegate all other and consenting bonds on a parity but subordinate to them.

"Preliminarily it should be noted that Subsection (b) of Section 80 specifies that

"'A plan of readjustment within the meaning of this chapter (1) shall include provisions modyfying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; and (2) may contain such other provisions and agreements, not inconsistent with this chapter, as the parties may desire.'

"The matter just quoted might be interpreted to mean that valid and existing liens can be distributed

and impaired in taxing districts debts readjustments under the addition of May 24, 1934, to the National Bankruptcy Act. (Compare *Rock Island Ry. Reorganization* cases, *supra.*) Such construction is unnecessary in this proceeding, my conclusion in this matter as to the asserted lien of bonds of the First and Second issues being controlled by local law."

Again he says.

"When the method of payment of the bonds and their coupons is considered, it is made more clear that no preference or priority of any one bond over another is intended by the Act as a whole, notwithstanding the apparently contradictory terms of Section 40 as it stood when the first two issues became effective. This mode of payment is found in Section 52, which in the Act of 1897 provided:

"Upon presentation of the coupons to the treasurer he shall pay the same from the bond fund."

There is no distinction or latitude justified on the part of the treasurer. He is compelled to pay upon presentation. This negatives any preferential right as between bonds of different issues.

"The Supreme Court said in approving a Canadian method of relieving a financially embarrassed railway company of its unmeetable bond obligations against the protest of dissatisfied investors, in *Canada Southern R. Co.* v. *Gebhard,* 109 U. S. 527:

" 'The confirmation and legalization of 'a scheme of arrangement' under such circumstances is no more than is done in bankruptcy when a 'composition' agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assenting minority. In no just sense do such governmental regulations deprive a person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not unnecessarily to injure another. Bankrupt laws

have been in force in England for more than three centuries, and they had their origin in the Roman law. The Constitution expressly empowers the Congress of the United States to establish such laws. Every member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relation to others, he might have retained. Such concessions make up the consideration he gives for the obligation of the body politic to protect him in life, liberty and property. Bankrupt laws, whatever may be the form they assume, are of that character.'

And in that case the Court added:

"'It is in entire harmony with the spirit of bankrupt laws, the binding force of which, upon those who are subject to the jurisdiction, is recognized by all civilized nations. It is not in conflict with the Constitution of the United States, which, although prohibiting States from passing laws impairing the obligation of contracts, allows Congress 'to establish * * * uniform laws on the subject of bankruptcy throughout the United States.' Unless all parties in interest, wherever they reside, can be bound by the arrangement which is sought to be legalized the scheme may fail.'

I think the language just quoted is applicable and decisive here, especially as the same Court said in the *Rock Island Railway Reorganization cases, supra,* in discussing the authoritative force of such language in other cases,

"'It is unnecessary to consider the criticism sometimes made, that these excerpts are dicta merely, since we are of opinion that they are sound in principle.'

"In my opinion, the plan set forth by the petition and established by the evidence in this proceeding is fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any class of creditors, and complies with all requirements of Section 80 of the National Bankruptcy Act as added May 24, 1934.

"It is accordingly so ordered; and it is further ordered that upon proof of compliance with the last proviso of Subsection (k) of said Section 80, a decree finally confirming said plan will be entered herein.

Dated this 2nd day of May, 1935."

I wish to call attention to the fact that the opinion of Judge McCormick is dated May 2, 1935 and is one of the latest opinions holding the act in question constitutional. The opinion, taken as a whole, shows that the Judge gave a great deal of consideration to the opinion.

Then again we wish to call the court's attention to the opinion of St. Sure, in the matter of East Contra Costa Irrigation District, which opinion was referred to by Judge McCormick. This also considered the constitutionality of the Summers-Wilcox Bill and concludes that there is no doubt but what the same is constitutional. We wish to refer to this decision in its entirety.

POINT B.

The Act of May 24, 1934, being the act in question, does not violate the 10th Amendment of the Federal Constitution which provides powers not delegated to the United States by the Constitution are reserved to the States.

Thus, Mr. Justice Van Devanter, in *Indian Motocycle Co.* v. *United States*, 283 U. S. 570, said:

"Thus, as to persons or corporation which serve as agencies of government, National or State, and also have private property or engage on their own account in business for gain, it is well settled that the principle does not extend to their private property or private business, but only to their operations or acts as such agencies; and, in harmony with this view, it also has been held where a State departs from her usual governmental functions and 'engages in a business which is of

private nature', no immunity arises in respect of her own or her agents' operations in that business."

In *Willcutts* v. *Bunn*, 282 U. S. 216, Chief Justice Hughes said with reference to an attack made upon a section of the Federal Income Tax Law:

> "It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication. The constitutional provisions authorizing the Congress to lay taxes (Article 1, Section 8; Sixteenth Amendment) are certainly broad enough to cover the tax in question, and before we can restrict their application upon the ground of a burden cast upon the State's borrowing power, there the tax is not laid upon the contracts made by the State in the exercise of that power, or upon the amounts payable thereunder, but is laid upon the result of distinct transaction by private owners, it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed."

The decision of the Supreme Court of the United States in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, and *Wheeler Lumber, Bridge & Supply Co.* v. *United States*, 281 U. S. 572, and many others, illustrate the same principle.

From these decisions it clearly appears that the test to be applied in determining whether an Act of Congress violates the sovereignty of the States, is not whether the act has any application to the States or to their instrumentalities of government, but rather whether it impairs or impedes the governmental functions of the States and of their instrumentalities, and where the express power is conferred upon Congress to legislate upon a subject, the act is not unconstitutional, merely because it is applicable to a State or a municipality, or affects them in some indirect way, without in any manner impeding or impairing their powers of government.

Congressional legislation applicable to municipal corporations, or their State agencies, is no new development in our law. Under the Commerce Clause of the Constitution Congress has power to fix rates which may be charged by a railroad engaged in interstate commerce even though it be owned and operated by a State. *Cincinnati N. O. & Texas Pac. Railway* v. *Interstate Commerce Commission*, 162 U. S. 184; *Interstate Commerce Commission* v. *Detroit, Etc., Ry Co.*, 167 U. S. 633, and in *South Carolina* v. *United States*, 199 U. S. 437, the power of the Federal Government to levy an excise tax upon the State dispensaries of intoxicating liquors was sustained. These decisions clearly recognize the fact that the dual system of government, contemplated by the Constitution, does not prevent Congress from legislating upon subjects confided to it merely because the legislation is applicable to a State, without impairing its sovereignty.

The power of Congress to enact legislation upon the subject of bankruptcies is plenary. Certainly it is as broad in scope as the power to establish Federal courts. It has never been questioned that Congress has the power to set up a system of Federal courts in which municipal corporations of the State may sue and be sued. Indeed, if the grounds for Federal jurisdiction exist, a municipality may be sued in the Federal court without its consent, and, similarly, a municipality may, of its own volition, bring suit in a Federal court to enforce a cause of action against a citizen. It would hardly be questioned that a municipality would have the right to intervene in a bankruptcy proceeding pending in the Federal courts to file its claim against the bankrupt, or for other proper purposes. Certainly in one of these cases would any question of State sovereignty arise. It seems clear, therefore, that the bill is not unconstitutional merely because it permits a municipality of

a State to avail itself of the jurisdiction of the Federal courts.

Municipal corporations and taxing districts exist in two capacities—governmental and corporate. In early times, their corporate functions were negligible. Under modern conditions, they frequently overshadow their governmental functions. The Sumners Bill is applicable to municipalities and taxing districts in their corporate capacity. In their corporate capacity they are to be treated for all practical purposes as private corporations. In *Broughton* v. *Pensacola*, 93 U. S. 266, it was said:

> "Although a municipal corporation, so far as it is invested with subordinate legislative powers for local purposes is a mere instrumentality of the State for the convenient administration of government; yet, when authorized to take stock in a railroad company, and issue to obligations in payment of the stock, it is that extent to be deemed a private corporation, and its obligations are secured by all the guarantees which protect the engagements of private individuals."

This language was approved in *Mount Pleasant* v. *Beckwith*, 100 U. S. 514, and in *Mobile* v. *Watson*, 116 U. S. 289.

When a municipality or other taxing district issues bonds, it acts in a dual capacity. In the issuing of the bonds it is exercising the sovereign power to contract, and the Congress of the United States possesses no power to impede or impair the execution of that power. But, having issued the bonds and the soverign power having been exercised, its relation to its creditors upon the bonds is not that of a soverign, but of a corporation, and it is so treated by the courts in all controversies which arise between it and its creditors. Thus it may sue or be sued in either State or Federal courts, upon questions arising out of the contracts, and unless restricted by law, it possesses practically the same powers to liquidate or adjust them which are pos-

sessed by material persons. Thus in Dillon on Municipal Corporations, 5th Edition, Sec. 821, it is said:

> "Growing out of its authority to create debts and to incur liabilities, a municipal corporation has power to settle disputed claims against it, and an agreement to pay these is not void for want of consideration."

In Section 822, Judge Dillon remarks:

> "As a general proposition, municipal corporations have, unless specially restricted, the same powers to liquidate claims and indebtedness that natural persons have, and from that source proceeds power to adjust all disputed claims, and when the amount is ascertained to pay the same as other indebtedness. It would seem to follow therefrom that a municipal corporation, unless disabled by positive law, could submit to arbitration all unsettled claims with the same liability to perform the award as would rest upon a natural person, provided, of course, that such power be exercised by ordinance or resolution of the corporation authorities."

If municipalities possess the power to compromise or arbitrate claims against them, and if they possess the power to proceed in the Federal Courts to determine disputes upon contracts, which they have made with others, or if they may may be sued by others in the Federal courts upon such contracts, upon what theory is a bill unconstitutional which permits a municipality to institute a proceeding in the Federal court for the readjustment of its indebtedness? In effect it might be said that the proceeding provided by the Sumners Bill is merely an arbitration between the municipality and its creditors. The award, it is true, is binding upon parties who have not appeared in the proceeding, but have merely been served with process by publication, but certainly that fact is no impairment of the powers of the municipality or taxing district. That is the very reason the municipality or taxing district instituted the

proceeding. If it can be complained of at all, it can only be complained of by those parties, who must show that their constitutional rights have been violated.

As a matter of fact I am of the opinion that even where the act made applicable to the State, it would not be unconstitutional. A proceeding cannot be instituted under the Act except by the public agency. Moreover, it must come into the Federal Court voluntarily. Even the states may submit to the jurisdiction of the Federal Courts. When they do so, they waive their sovereignty and waive the immunity guaranteed to them by the Eleventh Amendment to the Federal Constitution; and they are then bound by the decision of the same extent as any other litigant. *Clark* v. *Bernard*, 103 U. S. 436; *Gunter* v. *Atlantic Coast Line*, 200 U. S. 273.

In *Mott on Due Process of Law*, it is said at page 302:

> "114. The earliest definition of the police power practically identified it with the powers of sovereignty. In 1851 Chief Justice Shaw gave the often quoted definition of it as 'the power vested in the legislature by the constitution to make, ordain and establish all manner of wholesome and reasonable laws, statutes, and ordinances, either with penalties or without, not repugnant to the constitution, as they shall judge to be for the good welfare of the Commonwealth, and of the subjects of the same.' Both Cooley and Freund have adopted similarly broad definitions. The tendency of the courts, now however, is to narrow the concept to 'the power inherent in a government to enact laws, within constitutional limits, to promote the order, safety, health, morals and general welfare of society' ".

The Municipal Bankruptcy Act expressly provides in Section 80 thereof "nothing contained in this chapter shall be construed to limit or impair the power of any State to control by legislation or otherwise any political subdivision

thereof in the exercise of its political or governmental powers."

How or in what manner the act interferes with the State's right to legislate "for the order, safety, and morals" of the State's citizens is beyond our understanding.

POINT C.

The Act of May 24, 1934, being the act in question, does not impair the rights of the State in any way.

The arguments given under Point B is referred to in full.

POINT D.

The Act of May 24, 1934, being the act in question, does not violate the 5th Amendment to the Federal Constitution in that it deprives the bondholders of their property without due process of law, for the reason that due process of law is given and said act does not apply unless 66⅔ per cent of the bondholders agree thereto and it is conceded then to be for their best interest.

We do not believe it is necessary to present much argument to support this point, because we believe it has definitely been decided so many times and the constitutionality of which has always been upheld. The Railroad case cited under Point A is definite; in that case the Railroad Company was required to secure an approval of 66⅔% of its bondholders. The same is a requisite of the Sumners-Wilcox bill.

We might also call attention to the fact that this is true in all cases of composition of creditors, which has likewise been held to be constitutional even though the amount required is only 50% instead of 66⅔%, as required under this Act.

In *Canada Southern Railroad Co.* v. *Gebhard,* 109 U. S. 527, Chief Justice Waite declared the Canadian arrangement, under consideration, to be legal and in opinion he said:

> "Hence it seems to be eminently proper that where the legislative power exists some statutory provision should be made for binding the minority in a reasonable way by the will of the majority; and unless, as in the case in the States of the United States, the passage of laws impairing the obligation of contracts is forbidden, we see no good reason why such provision may not be made in respect to existing as well as prospective obligations. The nature of legislative supervision for the good of all, unless restrained by some constitutional prohibition, seems almost necessarily to form one of their ingredients, and when insolvency is threatened, and the interests of the public, as well as creditors, are imperiled by the financial embarrassments of the corporation, a reasonable 'scheme of arrangement' may, in our opinion, as well be legalized as an ordinary 'composition in bankruptcy.' In fact such 'arrangement acts' are a species of bankrupt acts. * * * It is in entire harmony with the spirit of bankrupt laws, the binding force of which, upon those who are subject to the jurisdiction is recognized by all civilized nations. It is not in conflict with the Constitution of the United States, which, although prohibiting States from passing laws impairing the obligation of contracts, allows Congress to establish uniform laws on the subject of bankruptcy throughout the United States."

POINT E.

The Reconstruction Finance Corporation has ample authority to come to the aid of the Irrigation Districts and advance money to said districts to enable the districts to carry on and furnish water to the farmers to make crops where they could not otherwise do so.

Public Act No. 2 of the 72nd Congress, approved January 22, 1932, as amended.

General Arguments.

It is to be noted that the Legislature of the State of Texas passed, by a unanimous vote, on the 27th day of April, 1935, an Act authorizing municipalities; political subdivisions and tax districts to take advantage of the Federal Bankruptcy Act and declared an emergency. This Act, without question, waives the issue of States' rights. This law is set out in full on page 61 of the brief of appellants in the Circuit Court of Appeals for the Fifth Circuit.

The Supreme Court of the United States has held many times that the approval by a majority of the creditors is *prima facie* evidence that the offer made will be for their best interest, and therefore it would not be taking property without due process of law. These authorities are set out in full on pages 79 and 80 of appellants' brief filed in the Circuit Court of Appeals.

> "*In re Kinnane Co.* (D. C. Ohio, 1915) 221 F. 762; *In re Goldstein* (D. C. Conn. 1914), 213 F. 115; *In re Barde* (D. C. Or. 1913) 207 F. 654; *In re Hoxie* (D. C. Me. 1910), 180 F. 508, 25 Am. Bankr. Rep. 32; *In re Waynesboro Drug Co.* (D. C. Ga. 1907), 157 F. 101, 19 Am. Bankr. Rep. 487; *In re Joseph* (C. C. N. Y. 1885), 24 F. 137; *Bolles* v. *Kelley* (Mass. 1915), 222 F. 63, 137 C. C. A. 601; *In re Rivkin* (D. C. Conn. 1914), 216 F.

218; *In re H. J. Arrington Co.* (D. C. Va. 1902), 113 F. 498, 8 Am. Bankr. Rep. 64; *City Nat. Bank* v. *Doolittle* (Tex. 1901), 107 F. 236, 46 C. C. A. 258, 5 Am. Bankr. Rep. 735; *In re Spiller* (D. C. Mass. 1916), 230 F. 490; *In re Griffith Stillings Press* (D. C. Mass. 1917), 244 F. 315."

To illustrate this question, we would like to refer the Court to the statement of C. M. Shanks, President of the Prudential Life Insurance Company of New York. Mr. Shanks' company holds $150,000,000 of municipal bonds of which several million were in default. Mr. Shanks was in favor of the bill, and went before Congress and made the following statement: "From the point of view of the investor we fear what is going to happen and we are very much in favor of the passage of this bill."

The opinion of the Circuit Court of Appeals does not in any way violate or contradict the opinion of the Supreme Court in the Frazier-Lemke Act which was decided on May 22, 1935, and we wish to give the following quotation from said opinion:

> "Nor do the provisions of the bankruptcy act concerning compositions afford any analogy to the provisions of paragraph 7. So far as concerns the debtor, the composition is an agreement with the creditors in lieu of a distribution of the property in bankruptcy—an agreement which 'originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by his creditors.' *Nassau Smelting & Refining Works, Ltd.*, v. *Brightwood Bronze Foundry Co.*, 265 U. S. 269, 271, 44 S. Ct. 506, 507, 68 L. Ed. 1013; *Myers* v. *International Trust Co.*, 273 U. S. 380, 383, 47 S. Ct. 372, 71 L. Ed. 692. So far as concerns dissenting creditors, the composition is a method of adjusting among creditors rights in property in which all are interested. In ordering the adjustment, the bankruptcy court exercises a power similar to that

long exercised by courts of law, *Head* v. *Amoskeag Mfg. Co.*, 113 U. S. 9, 21, 5 S. Ct. 441, 28 L. Ed. 889; and of admiralty, *The Orleans* v. *Phoebus*, 11 Pet. 175, 183, 9 L. Ed. 677. It is the same power which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite majority of the creditors. *Shaw* v. *Railroad Co.*, 100 U. S. 605, 25 L. Ed. 757; *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 46 S. Ct. 549, 70 L. Ed. 1028. Compare *National Surety Co.* v. *Coriell*, 289 U. S. 426, 53 S. Ct. 678, 77 L. Ed. 1300, 88 A. L. R. 1231; *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, 54 S. Ct. 298, 78 L. Ed. 465, 90 A. L. R. 391. In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court. Never, so far as appears, has any composition affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the mortgagee provided for in paragraph 3 of the Frazier-Lemke amendment (11 U. S. C. A. Sec. 203 (s) (3). They are not analogous to the so-called adjustment compelled by paragraph 7 (11 U. S. C. A. Sec. 203 (s) (7)."

It is to be noted that the opinion of the Circuit Court of Appeals for the Fifth Circuit decides every issue as the same should be decided under the authorities heretofore cited. Judge Foster states that there is nothing in the act which could be construed to limit the power of the State to control by legislation or otherwise any political subdivision thereof, and the judge also states this law is similar to the Railroad Act as decided by the Supreme Court.

In addition to the opinion of the Circuit Court of Appeals which is the only circuit court that has passed upon this question, there have been twenty United States Federal

judges who have held this act constitutional and only one holding the act unconstitutional, and that is Judge Kennerley of Houston whose opinion was reversed by the Fifth Circuit.

Prayer for Relief.

Since the opinion of the Circuit Court of Appeals clearly states the law as it is, we respectfully ask this Honorable Court to refuse the writ of certiorari in all things.

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